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SENATE STANDING COMMITTEE REPORT

February 22, 2007

Page 1 of 1

Mr. President:

We, your committee on **Business, Labor, and Economic Affairs** recommend that **Senate Bill 490** (first reading copy -- white) **do pass**.

Signed:

Vicki Cocchiarella
Senator Vicki Cocchiarella, Chair

- END -

Committee Vote:

Yes 7, No 4

Fiscal Note Required —

57

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SENATE STANDING COMMITTEE REPORT

February 22, 2007

Page 1 of 2

Mr. President:

We, your committee on **Business, Labor, and Economic Affairs** recommend that **Senate Bill 540** (first reading copy -- white) do pass as amended.

Signed: _____

Vicki Cocchiarella
Senator Vicki Cocchiarella, Chair

And, that such amendments read:

1. Title, line 7.

Following: "OF AN"

Insert: "ANTIQUE"

2. Title, line 9.

Strike: "SECTION"

Insert: "SECTIONS"

Following: "23-5-152"

Insert: "AND 23-5-153"

3. Page 2, lines 23 and 24.

Following: "An"

Insert: "antique"

Following: "by a" on line 23

Strike: remainder of line 23 through "operation" on line 24

Insert: "person licensed by the department to sell antique slot machines and antique illegal gambling devices as provided in 23-5-123"

4. Page 2, line 25.

Insert: "**Section 2.** Section 23-5-153, MCA, is amended to read:

"23-5-153. Possession and sale of antique slot machines and other antique illegal gambling devices. (1) For the purposes of this section, an antique slot machine is a mechanically or electronically operated slot machine that at any present time is more than 25 years old. An antique illegal gambling device is an illegal gambling device that at any present time is more than 25

Committee Vote:

Yes 8, No 3

Fiscal Note Required _____

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years old.

(2) Except as provided in subsection (3), an antique slot machine or antique illegal gambling device may be possessed, located, and operated only in a private residential dwelling.

(3) (a) An antique slot machine or antique illegal gambling device may be possessed or located for purposes of display only and not for operation:

(i) in a public or private museum; or

(ii) in any other public place if the machine or device has been made permanently inoperable for purposes of conducting a gambling activity.

(b) A licensed manufacturer-distributor or a person licensed under subsection (4) may possess antique slot machines and antique illegal gambling devices for purposes of commercially selling or otherwise supplying the machines.

(4) A person other than a licensed manufacturer-distributor may not sell more than three antique slot machines or three antique illegal gambling devices in a 12-month period without first obtaining from the department an annual license for selling the machines or other antique illegal gambling devices. The fee for the license is \$50 a year. The fee must be retained by the department for administrative purposes. The department may not issue a license under this subsection to a licensed operator.

(5) A person or entity legally possessing ~~a~~ an antique slot machine or illegal gambling device under subsection (2) or (3) may sell or otherwise supply a machine or device to another person or entity who may legally possess a slot machine or device.

(6) An antique slot machine or antique illegal gambling device may not be operated for any commercial or charitable purpose." "

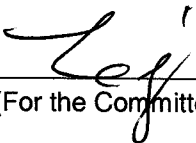
Renumber: subsequent sections

- END -

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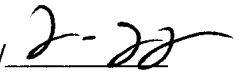
The **SENATE BUSINESS, LABOR, AND ECONOMIC AFFAIRS COMMITTEE** TABLED SB 495, by motion, on **Thursday, February 22, 2007**.



(For the Committee)



(Secretary of the Senate)

_____, 
(Time) (Date)

February 22, 2007

Cj Johnson, Secretary

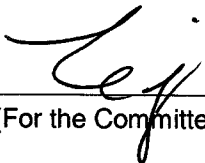
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TABLED BILL

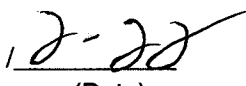
The **SENATE BUSINESS, LABOR, AND ECONOMIC AFFAIRS COMMITTEE** TABLED **SB 468**, by motion, on **Thursday, February 22, 2007**.



(For the Committee)



(Secretary of the Senate)

_____, 
(Time) (Date)

February 22, 2007

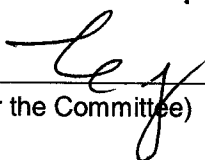
Cj Johnson, Secretary

Phone: 44-4762

COMMITTEE FILE COPY

TABLED BILL

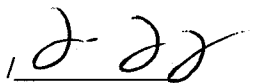
The **SENATE BUSINESS, LABOR, AND ECONOMIC AFFAIRS COMMITTEE** TABLED **SB 474**, by motion, on **Thursday, February 22, 2007**.



(For the Committee)



(Secretary of the Senate)

_____, 
(Time) (Date)

February 22, 2007

Cj Johnson, Secretary

Phone: 44-4762

MONTANA STATE SENATE
2007 LEGISLATURE

BUSINESS, LABOR AND ECONOMIC AFFAIRS

ROLL CALL VOTE

DATE 2-22-07 BILL NO. SB490 NUMBER 7-4

MOTION: Do Pass

PASSED

NAME	AYE	NO
SEN. JOE BALLYEAT (R)	✓	
SEN. ROY BROWN (R)	✓	
SEN. JOHN ESP (R)	✓	
SEN. VERDELL JACKSON (R)	✓	
SEN. LANE LARSON (D)	✓	
SEN. DON RYAN (D)		✓
SEN. FRANK SMITH (D)	✓	
SEN. CAROLYN SQUIRES (D)		✓
SEN. DONALD STEINBEISSER (R)	✓	
SEN. JOE TROPILA (D)		✓
SEN. VICKI COCCHIARELLA (D) - CHAIRWOMAN		✓

MONTANA STATE SENATE
2007 LEGISLATURE

BUSINESS, LABOR AND ECONOMIC AFFAIRS

ROLL CALL VOTE

DATE 2-22-07 BILL NO. SB 519 NUMBER 5-6

MOTION: TABLE

FAILED

NAME	AYE	NO
SEN. JOE BALLYEAT (R)		✓
SEN. ROY BROWN (R)		✓
SEN. JOHN ESP (R)		✓
SEN. VERDELL JACKSON (R)		✓
SEN. LANE LARSON (D)	✓	
SEN. DON RYAN (D)	✓	
SEN. FRANK SMITH (D)		✓
SEN. CAROLYN SQUIRES (D)	✓	
SEN. DONALD STEINBEISSER (R)		✓
SEN. JOE TROPILA (D)	✓	
SEN. VICKI COCCHIARELLA (D) - CHAIRWOMAN	✓	

MONTANA STATE SENATE
2007 LEGISLATURE

BUSINESS, LABOR AND ECONOMIC AFFAIRS

ROLL CALL VOTE

DATE 2-22-07 BILL NO. SB 519 NUMBER 6-5

MOTION: DO PASS AS AMENDED

"Held in Committee to 2/23/07"

PASSED

NAME	AYE	NO
SEN. JOE BALLYEAT (R)	✓	
SEN. ROY BROWN (R)	✓	
SEN. JOHN ESP (R)	✓	
SEN. VERDELL JACKSON (R)	✓	
SEN. LANE LARSON (D)		✓
SEN. DON RYAN (D)		✓
SEN. FRANK SMITH (D)	✓	
SEN. CAROLYN SQUIRES (D)		✓
SEN. DONALD STEINBEISSER (R)	✓	
SEN. JOE TROPILA (D)		✓
SEN. VICKI COCCHIARELLA (D) - CHAIRWOMAN		✓

MONTANA STATE SENATE
2007 LEGISLATURE

BUSINESS, LABOR AND ECONOMIC AFFAIRS

ROLL CALL VOTE

DATE 2-22-07 BILL NO. SB474 NUMBER 7-4

MOTION: TABLE

PASSED

NAME	AYE	NO
SEN. JOE BALLYEAT (R)		✓
SEN. ROY BROWN (R)	✓	
SEN. JOHN ESP (R)	✓	
SEN. VERDELL JACKSON (R)		✓
SEN. LANE LARSON (D)	✓	
SEN. DON RYAN (D)		✓
SEN. FRANK SMITH (D)	✓	
SEN. CAROLYN SQUIRES (D)	✓	
SEN. DONALD STEINBEISSER (R)		✓
SEN. JOE TROPILA (D)	✓	
SEN. VICKI COCCHIARELLA (D) - CHAIRWOMAN	✓	

SENATE PROXY FORM

According to Senate Rule 30-70 (13) (f) , a committee member may vote by proxy using a standard form.

PROXY VOTE


I, the undersigned, hereby authorize Senator Verdell Jackson

to vote my proxy on any issue before the Senate Business & Labor

_____ Committee

held on 2/22, 2007.

SB 450 - Y
SB 519 - N Tabled
amendment on SB 519 Y



SENATOR
STATE OF MONTANA

VISITOR REGISTER

DATE 2-22-07

BILLS BEING HEARD TODAY SBW 90, 495, 519, 540

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PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY



Employment Charts

State Statute Chart on Drug Testing in the Workplace

State	Drug Free Workplace Policy	Drug Testing Regulations	Workers' Compensation	Unemployment Insurance
Alabama	No statutory provision	No statutory provision	<p>§25-5-330 (1995) Provides a 5 percent discount to employers who establish a drug-free workplace in compliance with the act.</p> <p>§25-5-51 (1993) An employer may deny benefits if the employee's injury was due to intoxication from the use of alcohol or impaired by illegal drugs.</p>	<p>§25-4-78(3)(a) (1995) An employee may be partially disqualified from receiving benefits if the employee is discharged for misconduct connected to work. Misconduct includes the use of illegal drugs or failing to cooperate with a drug test after a previous warning has been given.</p>
Alaska	No statutory provision	<p>§23.10600-23.10.699 (1997) Provides protection to employers who establish a drug and alcohol policy and testing program in compliance with the act. Collection, testing and confidentiality procedures are mandated.</p>	<p>§23.30.080 (1993) An employer may not be liable for an employee's injury or death when the injury arises from the employee's willful intoxication.</p>	No statutory provision
Arizona	§23-493 (1999) Department of Corrections employees and job applicants subject to testing.	<p>§23-493 (1994) Private-Sector Drug Testing and Alcohol Impairment Act. A voluntary law that provides legal protection to employers for acting in good faith based on the results of a positive drug or alcohol test, provided the program meets the requirements of the act.</p>	<p>HB 2306 (2003) Removes restrictions on employer's ability to discipline or discharge an employee involved in a work-related injury who tested positive for drugs or alcohol during the time the injury occurred</p>	<p>§23-619.01 (1993) An individual may be disqualified from receiving benefits in the employee is discharged for willful or negligent misconduct associated with employment. Misconduct includes, repeated intoxication (alcohol or use of illegal drugs) on the employer's premises or when reporting to work.</p>

Arkansas	§11-14-101 (1999) Establishes voluntary drug free workforce program.		§11-9-401(a), 11-9-707 An employer may use an employee's intoxication or being under the influence of drugs as a defense. Must prove the injury was substantially caused by the worker's intoxication at the time of the injury. §11-14-101 (1999) Employers with acceptable drug-free workplace programs drug-free workplace programs may qualify for a 5% discount on workers' compensation premiums.	§11-10-514(b) (1993) An employee may be denied benefits if he/she is discharged for using alcohol or controlled substances on the job, or reporting to work while intoxicated, including use of controlled substances.
California	Gov't Code §8350-8356 (1993) Requires all state contractors and grantees to implement a drug free workplace policy and establish an employee drug awareness education program.	No statutory provision	Labor Code §3600, §5705 Benefits may be denied if an employee's injury was caused by intoxication or the unlawful use of a controlled substance. Employer carries the burden of proof.	Unemp. Ins. Code §2626 An individual may be disqualified from receiving unemployment compensation benefits if discharged for being intoxicated while or work or for certain behavior related to intoxication.
Colorado			§8-42-112(1)(c) Benefits may be reduced when an injury results from the intoxication of an employee.	§ 8-73-108(5) (1993) An employee may be disqualified from receiving benefits if the employee engages in off the job use of alcohol or controlled substances to a degree that it interferes with job performance or on the job use of alcohol or controlled substance.
Connecticut		§31-51t (1992) Prohibits certain types and testing. In general, testing is limited to employee's in high risk positions or where reasonable suspicion exists.	§31-275(1)(c) (1993) Provides that disability or death due to use of alcohol or drugs is not a compensable injury.	§31-236 (1992) An employee is ineligible for benefits if the employee was discharged for "just cause" or repeated willful misconduct.
Delaware				
District of Columbia				

Florida	<p>§112.0455 (1996) The Drug Free Workplace Act provides that any state agency may test certain employees and job applicants for the use of drugs. Does not require testing but mandates that any agency choosing to do so must comply with methods and procedures outlined.</p> <p>§287.087 Provides that in situations where two or more bids of equal merit are submitted the business certifying it has implemented a Drug-Free Workplace program will be given preference in being awarded the contract.</p>	SB 50A (2003) Revises provisions regarding drug testing.	<p>§440.102 (1996) Voluntary law that provides a 5 percent reduction in premiums to employers who implement and maintain a certified drug-free workplace program in accordance with the standards set forth in the Act. Positive drug test results disqualifies an employee from receiving benefits.</p>	<p>§440.102 (1993) An employee may be denied benefits if tested positive for drugs on a test conducted in accordance with the standards set forth under worker's compensation laws. A positive drug test constitutes misconduct. §38B-2.017(5)(b) (1993) Consideration is given to the illnesses of alcoholism and drug addiction in determining eligibility.</p>
Georgia	<p>§50-24-1 (1993) Contractors who receive state contracts in the amount of \$25,000 or more must certify they have implemented a substance abuse prevention program.</p> <p>§45-20-90 Public employees in high-risk jobs may be subject to random drug</p>		<p>§33-9-40.2 & §34-9-410 Voluntary law that provides a 7.5 percent discount on workers' compensation premiums to employers who have implemented a drug-free workplace program that is certified by the state Board of Workers' Compensation. § 34-9-17 (1993) Provides an employee may be disqualified from receiving benefits if his or her injury or death is due to intoxication or the use of controlled substances.</p> <p>Act No. 378 (2005) Removes the existing eight-year limitation</p>	

	testing. Refusal to submit to a random test or testing positive results in termination from employment.		on the application of the insurance premium discount for the insured with the drug-free workplace program.	
Guam				
Hawaii		§329B-1 (1993) Procedural guidelines regarding workplace substance abuse testing. Most regulations apply to the laboratory but the employer is required to use a laboratory that is certified by the Hawaii Dept. of Health or the Substance Abuse and Mental Services Admin. Of the USDHHS.	§431:14-103 (1997) Provides a discounts of at least 5 percent on premiums to employers who maintain an effective safety and health program. Does not specifically mention drug-free workplace but does direct the DOL to issue standards and rules. §386-3 Denies compensation if an employee's injury was incurred as a result of intoxication. Employer has burden to prove intoxication.	
Idaho	§72-1701-1715 (1997) "Private Employer Alcohol and Drug-Free Workplace Act" Voluntary law that permits employers to test employees and applicants for drugs and alcohol. Provides requirements for collection and testing. Limits employer liability for establishing a testing program in compliance with the act. Establishes that an employee who is discharged for a confirmed positive drug or alcohol test, refusing to be tested, adulterated or attempting to adulterate a test sample would be discharged for misconduct for purposes of unemployment insurance.	Chapter No. 224 (2004) Adds to existing law relating to the Idaho Employer Alcohol and Drug-free Workplace Act to provide certain eligibility requirements for contractors relating to state construction contracts	§72-208 Payments may be reduced by 50% when the proximate cause of the injury is the employee's use of intoxicants. SB 1119 (2003) Provides that public employers who conduct drug and alcohol testing of all current and prospective employees shall qualify for and may be granted an employer Workers' Compensation premium reduction.	
Illinois	§132.211 (1993) Drug-Free Workplace Act Provides that employers who are awarded a state			

	contract or grant must adopt an anti-drug policy and program, and provide a copy of its policy. Does not specifically address drug testing.			
Indiana			§22-3-2-8, 22-3-7-21 (1993) Denies workers' compensation benefits to employees whose injury or death was caused by intoxication.	§22-4-15-1(d) An employee who is discharged for "just cause" is disqualified from receiving benefits. "Just cause" includes reporting to work under the influence of alcohol or drugs, consuming alcohol or rugs on the employer's premises during work hours.
Iowa		§730.5 (1998) Authorizes most types of drug and alcohol testing provided that specific procedural and policy requirements are met. Employers who develop, implement and maintain programs in accordance with the provisions of the act are provided with immunity against any causes of action arising against the employer for actions taken pursuant to the program.	§85.16 (1993) Provides that an employee may be disqualified from benefits coverage if the employee's injuries are caused by the employee's intoxication or use of drugs, or if the intoxication was a substantial factor in causing the injury.	§96.5(2) Employee may be disqualified for benefits if discharged for misconduct in connection with work.
Kansas		Chapter No. 54 (2005) Changes the burden of proof to the claimant for admission of chemical drug and alcohol test results into evidence. Chapter No. 105 (2004) Relates to failing a pre-employment drug screen.	§44-501(d)(2) Denies benefits when an injury, disability or death was contributed to by the employee's use or consumption of alcohol or drugs. It is conclusively presumed that the employee was impaired due to alcohol if it is shown that at the time of the injury the employee's alcohol concentration was .04 or more.	§44-706(b)(2) (1993) Denies unemployment benefits to employees who are discharged for misconduct related to drug or alcohol impairment. Chapter No. 33 (2005) Regards disqualification from receipt of benefits relating to dismissal, failure of pre-employment drug screen.

Kentucky			<p>§342.610 (1993) Denies workers' compensation benefits when the employee's injury was proximately caused by the employee's intoxication.</p>	<p>§341.370 (1993) Denies unemployment compensation benefits to any employee who is discharged for misconduct connected with work. Misconduct includes reporting to work under the influence of alcohol or drugs or consuming alcohol or drugs on the employer's premises during work hours.</p>
Louisiana	<p>Executive Order 9838 (1998) Provides for mandatory testing of all prospective state employees.</p>	<p>§49:1001(1993) Restricts the types of testing but does not place specific requirements on drug testing procedures. Provides protection to employers who establish and maintain a drug and alcohol testing program in compliance with the law.</p> <p>§23:879 (1997) Prohibits an employer from requiring an employee or applicant to pay for a drug test. Payment may be withheld if an applicant resigns within 90 days.</p> <p>§47:6010 Employers may be eligible for a tax credit against their state income tax in the amount of 5 percent of the "qualified treatment expenses" incurred by the employer for substance abuse treatment services.</p>	<p>§23:1081 (1993) An employer may deny benefits to an employee whose injury is caused by his or her intoxication. A positive drug test conducted in accordance with the law or a positive alcohol test at .10 or higher is needed to presume intoxication.</p>	<p>§23:1601(10)(1)-(f) (1993) Benefits may be denied to an employee who is discharged for misconduct. On or off the job drug, as evidenced by a positive drug test, conduct in accordance with the law.</p>
Maine		<p>Title 26 §681 (1993) Places restriction on types of testing and places specific requirements that must be met for drug testing procedures. Maine Department of Labor must approve all programs.</p>	<p>Title 39-A §202 (1993) Denies benefits to an employee whose injury was the result of his or her intoxication unless the employer knew at the time of the injury that the employee was intoxicated.</p>	
Maryland		§17-214 (1997)	§9-506(c) (1993)	

		Requires specific technical procedures must be followed with regard to drug testing. The laboratory must be certified by the MD Dept. of Health & Mental Hygiene. Hair testing is permitted for pre-employment testing only.	Denies benefits to an employee whose injury is caused primarily by the use of controlled substances not prescribed by a physician.	
Massachusetts				
Michigan				§421.29 (1993) Provides an employee may be disqualified from receiving benefits if discharged for misconduct connected with work, including intoxication while at work.
Minnesota		§181.950 (1997) Places restrictions on the types of testing that may be conducted and places requirements on drug testing procedures. An employee may not be discharged solely on the basis of a first-time positive drug test. Rehabilitation must be offered. Employers may only inquire about prescription medications after a positive drug test.	§176.021 (1993) Benefits may be denied if the employee's intoxication is the proximate cause of the injury. Burden of proof on employer.	§268.09(c)(2) (1994) May deny benefits to an employee who is unemployed because of a chemical dependency that has been professionally diagnosed; or participating in a treatment program and who is unable to successfully complete treatment as advised. This action indicates an employee has not made a reasonable effort to retain employment.
Mississippi		§71-7-1 (1993) Compliance with state drug testing law is voluntary. Employers are protected from civil liability with regard to their drug and alcohol program and testing. Permits all types of testing and includes specific requirements with regard to testing procedures.	§71-3-201 (1997) Provides for a 5 percent reduction in workers' compensation premiums to employers who establish a drug free workplace program. Employers must have a written policy statement, conduct drug and alcohol testing, maintain a resource list of EAP providers, provide education and supervisor training and maintain confidentiality standards. §71-3-7 (1993) Benefits are denied if the employee's intoxication is the proximate cause of injury.	§75-5-513 Provides that discharge for drug use constitutes willful misconduct and disqualifies an employee from receiving unemployment compensation.
Missouri			§287.120 (1993) Provides benefits may be reduced 15 percent if employee was injured in connection with drug or alcohol use or failure to obey company rules, provided the drug policy was conspicuously posted, employee had actual knowledge of the rule, and the employer shows that prior to	

			the injury it made a diligent effort to inform the employee of the rule. Benefits may be denied if alcohol or drug use was the proximate cause of the injury.	
Montana		§39-2-304 (1997) Drug testing with restriction, is permitted of employees "engaged in the performance, supervision, or management of work in a hazardous work environment, security position, position affecting public safety, or fiduciary position." Testing must be in accordance with 49 CFR, Part 40 of the DOT's regulations.		
Nebraska		§48-1901 (1993) Permits drug and alcohol testing provided certain technical procedures are followed. Positive test, refusal to be testing, tampering with specimen are all grounds for dismissal.	§48-127, 48-102 (1993) Benefits may be denied to any employee whose injuries were due to intoxication - including controlled substances not prescribed by a physician.	
Nevada			§616.565 (1)(c) (1993) Benefits may be denied when an injury is proximately caused by employee's intoxication - alcohol or controlled substances. If intoxicated at the time of the injury it is presumed the intoxication is the proximate cause unless rebutted by evidence to the contrary.	§612.485 Employee is ineligible for unemployment compensation benefits if discharged for misconduct.
New Hampshire			§281-A:14 (1993) Employer not liable for injuries sustained by an employee which were caused in whole or in part by employee's intoxication - drug or alcohol. This does not apply if the employer knew the employee was intoxicated at the time of the accident.	§282-A:34 (1993) Benefits are denied if an employee has been discharged for intoxication or for use of controlled substances, to the degree that it seriously hampered or interfered with their work.
New Jersey			§34:15-7 (1994) Denies benefits if the proximate cause of the injury is intoxication or the unlawful use of controlled dangerous substances. Employer must establish intoxication.	§43:21-5 (1994) Benefits may be denied if the suspension or discharge was for misconduct related to work.
New Mexico			§52-1-11 (1993) Benefits may be denied if the injury was occasioned by the employee's intoxication.	
New York			Workers' Compensation §10 (1992) Benefits may be denied when the injury is occasioned solely by the employee's intoxication from alcohol or controlled substance. There is a presumption that the injury did not occur solely from	Labor §593 (1993) An employee may be disqualified from receiving benefits if the employee tests positive on a drug

			intoxication.	test or for using alcohol or drugs in violation of work rules.
North Carolina		§95-230 (1993) Does not restrict the types of testing that may be conducted but requires certain procedures be followed as to the process.	§97-12 (1993) Denies benefits if the employee's injury is proximately caused by intoxication, provided the intoxicant was not provided by the employer. Session Law 448 (2005) Relates to ineligibility for benefits when a worker is injured while intoxicated or under the influence of a controlled substance.	§96-14(2) (1993) Employee discharged from work for misconduct may be denied benefits. Misconduct includes reporting to work significantly impaired by alcohol or illegal drugs, consuming either on the employee's premises or being convicted for manufacturing, selling or distributing controlled substances.
North Dakota		§34-01-15 (1999) Requires employers pay for applicant and employee drug or alcohol screening.	§65-01-02 (1993) Benefits are denied if the injury was caused by the use of intoxicants or controlled substances. Employer has burden of proof. A refusal to submit to a drug test results in forfeiture of all benefits. If an employee can prove he or she has successfully completed substance abuse treatment within one year of the benefits denial, the employee's benefits must be reinstated.	
Ohio		Session Law 115 (2004) Specifies conditions under which chemical testing of an employee may establish a rebuttable presumption that the employee's injury was proximately caused by use of alcohol or an unprescribed controlled substance	Rule 4123-17-58 Premium Reduction Rule State Bureau of Workers' Comp. has issued a rule that provides a five year phased in workers' compensation premium reduction that can rise as high as twenty percent. Discounts are offered based on types of drug-free workplace program implemented. At the lowest level (6 percent) employers must establish a written policy, conduct annual employee education and supervisor training and conduct drug and alcohol testing. As the discount rises, random testing must be introduced as well as health care coverage for chemical dependencies. §4123.54 (1993) Denies benefits to employees who are injured while under the influence of illicit drugs or alcohol where the intoxication was the proximate cause of the injury.	
Oklahoma		40 §551-565 (1994) Permits most types of drug testing provided certain conditions are met. An employee assistance program	85 § 11 (1994) Benefits may be denied if the injury results directly from intoxication or drug use of the injured employee while on duty.	40§2-406A (1994) Benefits denied when an employee is discharged on the basis of a refusal to undergo a drug or alcohol test or confirmed positive

		<p>must be made available to employees prior to conducting a test. The employer must establish a comprehensive policy that explains all aspects of the program as well testing procedures that must be followed.</p> <p>SB 1A (2005) Modifies circumstances under which certain drug testing may occur.</p>		<p>drug or alcohol test conducted in accordance with the state's drug testing law.</p>
Oregon	<p>§279.312 (1999) Requires that all public contracts include a condition that the contractor demonstrate an employee drug-testing program.</p>	<p>§438.435 (1993) Permits all types of drug testing but does request all tests be analyzed at state approved laboratories. Alcohol testing is only allowed if there is reasonable suspicion the employee is under the influence or if the employee consents.</p> <p>§802.200 (1999), §803.370 (1999), §825.955 (1999) Requires motor carriers have drug testing programs, specifies penalties for failure to establish program. Specifies that positive test results be entered into employee driving record.</p>	<p>§656.005(7)(b)(C) (1993) Benefits denied when an employer shows by clear and convincing evidence that a major contributing factor of an employee's injury was the use of controlled substances unless employer permitted, encouraged or had knowledge of such consumption.</p> <p>Chapter No. 792 (2003) Disqualifies an individual from receipt of unemployment benefits for acts involving alcohol, marijuana or unlawful drugs or violation of last chance agreement.</p>	
Pennsylvania			<p>77 §431 (1994) Benefits denied if injury caused by a violation of the law, including use of illegal drugs. Employer must prove the injury was due to drugs or alcohol. No compensation may be paid if the injury would not have occurred had the employee not been intoxicated.</p>	
Puerto Rico				
Rhode Island		<p>§28-6.5-2 (1996) Permits pre-employment testing, for cause testing, post accident testing, post rehabilitation testing and safety sensitive random testing if the employer has an employee assistance program available.</p>	<p>§28-33-2 (1993) Denies benefits to an employee whose injury or death is the result of intoxication or the use of controlled substances.</p>	

		Employer must adopt a comprehensive drug abuse prevention policy and adhere to testing procedures.		
South Carolina	§44-107-10 (1991) Drug Free Workplace Act. Requires every individual or business receiving a state grant or contract for \$50,000 or more must implement a drug free workplace program in accordance with the Act. Requirements include establishing distributing a written substance abuse policy and establishing an employee drug education awareness program.	Act No. 50 (2005) Provides a worker is ineligible for benefits if he or she refuses to take a drug test or tests positive during a drug test.	§38-73-500 (1997) Provides 5 percent discount on workers' compensation premiums to employers who voluntarily establish a drug free workplace program. Requires at a minimum an employer provide a written substance abuse policy, employee notification of program, confidentiality procedures and random sampling of all employees. §42-90-60, 42-11-100 (1993) Benefits may be denied if injury or death was occasioned by intoxication.	
South Dakota			§62-4-37 (1993) Employee may be disqualified from receiving benefits in injury due to willful misconduct, including intoxication or use of illicit drugs.	
Tennessee	SB 2255 (2002) Requires that all public contracts include a condition that the contractor demonstrate an employee drug-testing program.	Chapter No. 390 (2005) Applies the drug-free workplace program credit separately to each individual company for an employer having more than one company under one workers' compensation insurance policy.	§50-9-101 (1997) Provides 5 percent discount on premiums to employers who establish a drug free workplace program. Requires the employer have a written policy statement, a resource list of EAP's and other rehab programs, and drug and alcohol testing. §50-6-110 (1994) Denies benefits to an employee whose injury is due to intoxication or the use of illegal drugs.	§31-236(a)(9) (1999), §50-7-303 (a)(2) (1999) Establishes that employees discharged for refusal to take a drug or alcohol test, or for testing positive on such test, are disqualified for unemployment benefits.
Texas		§481.133 (1994) It is illegal to manufacture, deliver, own or use a substance or device designed to falsify drug test results.	§411.091 (1993) Requires employers with 15 or more employees adopt a policy designed to eliminate drug abuse in the workplace. Written policy must be distributed to each employee. Does not require drug testing or rehabilitation program be implemented. §406.032 (1993) Benefits are denied if the injury occurred while the employee was in a state of intoxication.	
Utah		§34-38-1 (1993) No cause of action may be brought against any employer who establishes a drug and alcohol testing program in compliance with the act.	§35-1-14 (1993) Benefits are denied when the major contributing factor of an employee's injury is the use of illegal substances, intentional abuse of prescribed substances or intoxication from alcohol at a level of .08 or higher, provided the employer did not permit or have knowledge of the	

		Employers may conduct any type of testing in order to maintain the safety of employees and the public or to maintain productivity and quality of services and products. All management personnel must also be subject to testing if a program is implemented. Specific requirements must be met with regard to testing procedures.	substances.	
Vermont		§511-520 (1993) Pre-employment testing is permitted if 10 days notice is given and is conducted with a physical examination. For cause testing is permitted if the employer has probable cause to believe an employee is under the influence of drugs while on the job. An employee testing positive must be given the opportunity to participate in an EAP.		
Virginia			<p>§65.2-813.2 (1997) Workers' Compensation Premium Reduction Program. Provides a 5 percent premium discount for employers who institute a drug free workplace program that meets the criteria established by the insurer.</p> <p>§65.2-306(A)(B) (1994) Denies benefits to an employee whose injury is caused by intoxication or use of controlled substance. A positive drug test from an HHS certified laboratory or a positive alcohol test above .08 bac creates a rebuttable presumption the employee was intoxicated or using drugs at the time of injury.</p> <p>HB 568 (2002) Provides that clear and convincing evidence is required to overcome the presumption that an employee who either had a blood alcohol level equal to or greater than 0.08% or yields a positive test result for use of a nonprescribed controlled substance from a certified laboratory was intoxicated due to consuming alcohol or using a nonprescribed controlled substance at the time of his injury or death</p>	<p>§60.2-618 (3)(d) (1998) Benefits are denied during any week that an individual tests positive for drugs in connection with a suitable offer of work.</p>
Virgin Islands				

Washington			<p>§49.82.010-.901 (1996) Workers' Compensation Premium Reduction Program. Provides a 5 percent premium discount for employers who implement a drug free workplace program. Program must include a written substance abuse policy, substance abuse testing, provide employee assistance services, comply with confidentiality standards and conduct employee education and supervisory training programs.</p>	<p>§50.20.060(1) (1993) Benefits may be denied if employee is discharged for misconduct which may include drug use.</p>
West Virginia	<p>25-1-11 (1999) Department of Corrections employees and job applicants subject to testing.</p>		<p>§23-4-2(a) (1993) Benefits may be denied to an employee whose injury was due to intoxication.</p>	<p>§21A-6-3(2) (1993) Benefits may be denied if discharged for misconduct for reporting to work intoxicated, being intoxicated at work, reporting to work under the influence of controlled substances or being under the influence of controlled substances while at work.</p>
Wisconsin			<p>§102.58 (1993) Benefits may be reduced by 15 percent if an employee's injuries are a result of being intoxicated or from the use of a controlled substance. Total reduction may not exceed \$15,000.</p>	
Wyoming			<p>§27-14-102(a)(xi)(B) (1993) For purposes of workers' compensation benefits an "injury" does not include those injuries caused by the employee's intoxication or by being under the influence of a controlled substance.</p> <p>Chapter No. 185 (2005) Authorizes the workers' safety and compensation division to define intoxicated or under the influence of a controlled substance for purposes of the exclusion from covered injury</p>	

Source: NCSL

January 2006



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MEMORANDUM

Montana Board of Investments

Department of Commerce

2401 Colonial Drive, 3rd Floor

Helena, MT 59601

(406) 444-0001

To: James Gillett
Deputy Legislative Auditor

From: Carroll South
Executive Director

Date: December 12, 2005

Subject: Pension Fund Portfolio Asset Allocation

At your request, I have reviewed the pension fund portfolios asset allocation changes and the reasons for the changes. This report covers the period from Fiscal Year 1993 through Fiscal Year 2005.

Pension Fund Portfolio Growth - The table below compares the fair value of each pension system's investment portfolio at the beginning and end of the period. Fair value means the actual value of all securities in the portfolio as priced on June 30. Depending upon market conditions and interest rates on the pricing date, fair value may be less or more than the actual amount paid for each security. The difference between the cost and fair value of a security on the date it is priced is considered unrealized gain or loss.

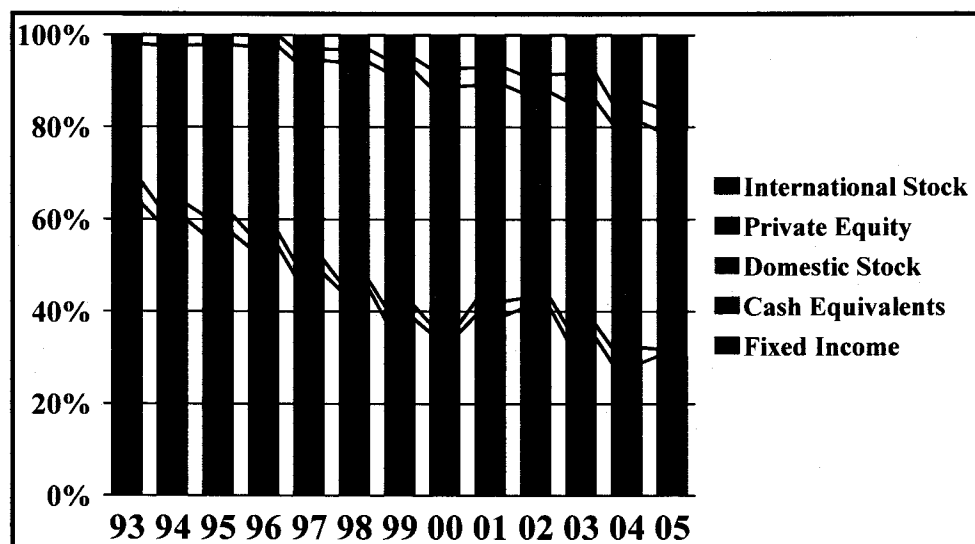
<u>Pension Systems</u>	<u>6/30/1993 Fair Value</u>	<u>6/30/2005 Fair Value</u>	<u>\$ Increase</u>	<u>% Increase</u>
Public Employees	1,300,428,994	3,232,788,978	1,932,359,984	148.59%
Teachers	1,085,429,287	2,461,155,345	1,375,726,058	126.74%
Police	50,799,530	153,724,535	102,925,005	202.61%
Sheriffs	51,677,340	151,006,508	99,329,168	192.21%
Firefighters	47,685,826	146,685,522	98,999,696	207.61%
Highway Patrol	38,628,109	83,578,823	44,950,714	116.37%
Game Wardens	15,886,460	51,750,698	35,864,238	225.75%
Judges	19,997,611	48,424,100	28,426,489	142.15%
Vol. Firefighters	8,685,028	20,063,456	11,378,428	131.01%
Total	<u>2,619,218,185</u>	<u>6,349,177,964</u>	<u>3,729,959,779</u>	<u>142.41%</u>

Portfolio Asset Allocation Changes - During this period, as the pension system investment portfolios grew the asset allocations changed significantly as shown in the table on the following page. The portfolios of all nine pension systems are included in the table and have been divided into five major asset classes for simplification.

- Cash Equivalent Short Term Investments that may be liquidated in 24 hours.
- Fixed Income Domestic Bonds and Residential Mortgages Traded in US Dollars
- Domestic Stock Stocks in US Domiciled Corporations Traded in US Dollars.
- International Stock Stocks in Foreign Corporations Traded in the Native Currency
- Private Equity Investments in Private and Illiquid Type Equity

Asset Type	1993		2005		% Change
	Fair Value	% of Total	Fair Value	% of Total	
Domestic Stock	785,276,246	29.98%	3,009,260,669	47.40%	17.41%
Private Equity	52,674,090	2.01%	313,903,080	4.94%	2.93%
International Stock			996,456,763	15.69%	15.69%
Total Equity	837,950,336	31.99%	4,319,620,513	68.03%	36.04%
Fixed Income	1,657,967,149	63.30%	1,928,431,419	30.37%	-32.93%
Cash Equivalents	123,300,700	4.71%	101,126,032	1.59%	-3.11%
Total Fixed Income	1,781,267,849	68.01%	2,029,557,451	31.97%	-36.04%
Total	2,619,218,185	100.00%	6,349,177,963	100.00%	

The percent of the pension portfolios invested in equities more than doubled during the period - from less than 32.0 percent to 68.0 percent. Fixed-income investments were reduced to 32.0 percent of the portfolios at the end of the period.



The adjacent chart shows the year-by-year change in the portfolio asset allocations during the period.

International stocks were added to the portfolio in 1997. From 1993 through 1996, the two large pension funds participated in a Convertible Bond Pool. Additionally, from 1999 through 2000, all nine pension funds

participated in a Real Estate Trust Stock Pool. The assets of these pools are included in the Domestic Stock bar portion of the chart.

The Importance of Asset Allocation – An important component of the “prudent expert principle” law governing the Board’s management of investments is to “*diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so.*” The asset allocation process is used to “diversify” investment portfolios as required by law and is a tool used by all institutional investors. Diversification

is sometimes referred to as not putting “all the eggs in one basket.” Another reason for a viable asset allocation process is to avoid or reduce the “correlation” of different asset classes. Ideally, different asset classes would respond differently to economic and changing capital market conditions – when one asset class return’s decline, an uncorrelated asset class may actually increase or at least not decline in tandem.

Generally, risk is directly related to return. Bank deposits guaranteed by the federal government and US Government bonds are considered to be safest and most liquid investments in the world but also provide the lowest rate of return over long time periods. On the other hand private equity investments, such as venture capital and leveraged buy-out investments, while risky and illiquid, historically have provided returns well in excess of the public equity markets. A well diversified investment portfolio includes both types of investments in prudent proportions.

There is an additional risk that must be considered when investing pension funds – the risk of not achieving the return assumptions on which the funds’ valuations are based. These valuations compare actuarial liabilities to actuarial assets and if the two do not match there will be an unfunded liability or surplus. If future investment returns do not meet the actuary assumptions for investment returns at the time the valuations were conducted, unfunded liabilities will increase and any surpluses will be reduced or eliminated.

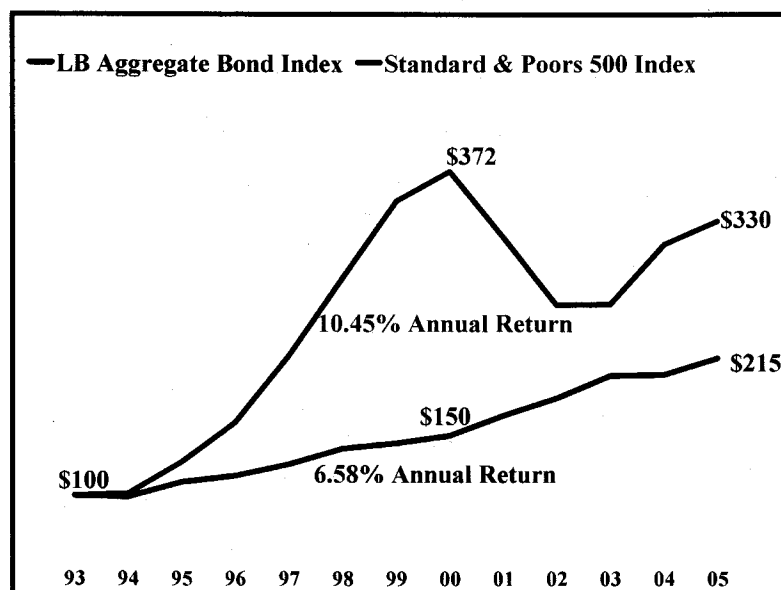
Reasons for Asset Allocation Changes - While the pension system actuaries do not dictate how pension assets are invested (the Board has sole authority), the Board’s asset allocation process for pension funds is directly influenced by the investment return expectations “built into” the actuarial assumptions. During the period covered by this report, the actuarial valuations assumed an 8.0 percent investment return for the nine pension systems (the Teachers’ Retirement System return assumption was reduced to 7.75 percent in 2004). Because equity investments have historically provided a much higher rate of return than have fixed-income investments, a significant increase in the 32.0 percent equity allocation at the beginning of the period was required to meet the 8.0 percent assumptions. During the period, the Board made a diligent effort to increase pension fund equity allocations.

The adjacent table shows the annualized investment return on major asset classes from 1926 through 2004 as compiled by the Ibbotson firm. Fixed-income returns are shown in red letters, while equity investments are shown in brown. Based on the historical returns of these asset classes, at least 54.0 percent of the pension assets should have been invested in equities at the beginning of the period to generate portfolio returns of 8.0 percent.

<u>Annualized Return *</u>	
<u>Investment Type</u>	<u>1926-2004</u>
Long-term Domestic Corporate Bonds	5.90%
Long-term Government Bonds	5.40%
Intermediate-term Government Bonds	5.36%
US Treasury Bills	3.72%
Large-cap Domestic Stock	10.43%
Small-cap Domestic Stock	12.74%
<u>* Ibbotson data</u>	

Although during the 1993 to 2005 period the bond market returned approximately 1.0 percent more than the historical average as shown in the chart on the following page, the 6.58 percent annual bond return would have fallen short of achieving the required return. While that difference may not seem significant in a percentage context it makes a significant dollar difference over long periods of time. For example, applied against the \$2.6 billion value of the pension portfolios at the beginning of the period, a 6.58 percent annual return would have reduced the portfolio value at the end of the period by \$968.6 million, compared to an 8.0 percent annual return.

Naturally Occurring Asset Allocation - During certain capital market conditions, asset allocations will change without any active asset allocations by investors. If an investment portfolio is split between fixed income and equity investments and the fixed income and equity markets perform much differently the asset allocation will change dramatically. For example, if the equity markets return 15.0 percent annually for a three-year period while the fixed income markets return only 5.0 percent, a 50/50 equity/fixed income split will change to 57.0 percent equities and 43.0 percent fixed income without investor intervention.



This natural-occurring asset allocation process was a significant factor during the period as shown in the adjacent graph. From 1995 through 2000, the domestic stock market as represented by the S&P 500 Index (representing 80.0 percent of publicly-traded domestic stock) significantly out performed the domestic bond market.

The bond market is represented by the Lehman Brothers Aggregate Bond Index (including more than 6,000 domestic corporate and government bond issues). One hundred dollars invested in the bond market on July 1, 2003 would have been

worth only \$150.00 in 2000, compared to \$372.00 for the same investment in the stock market.

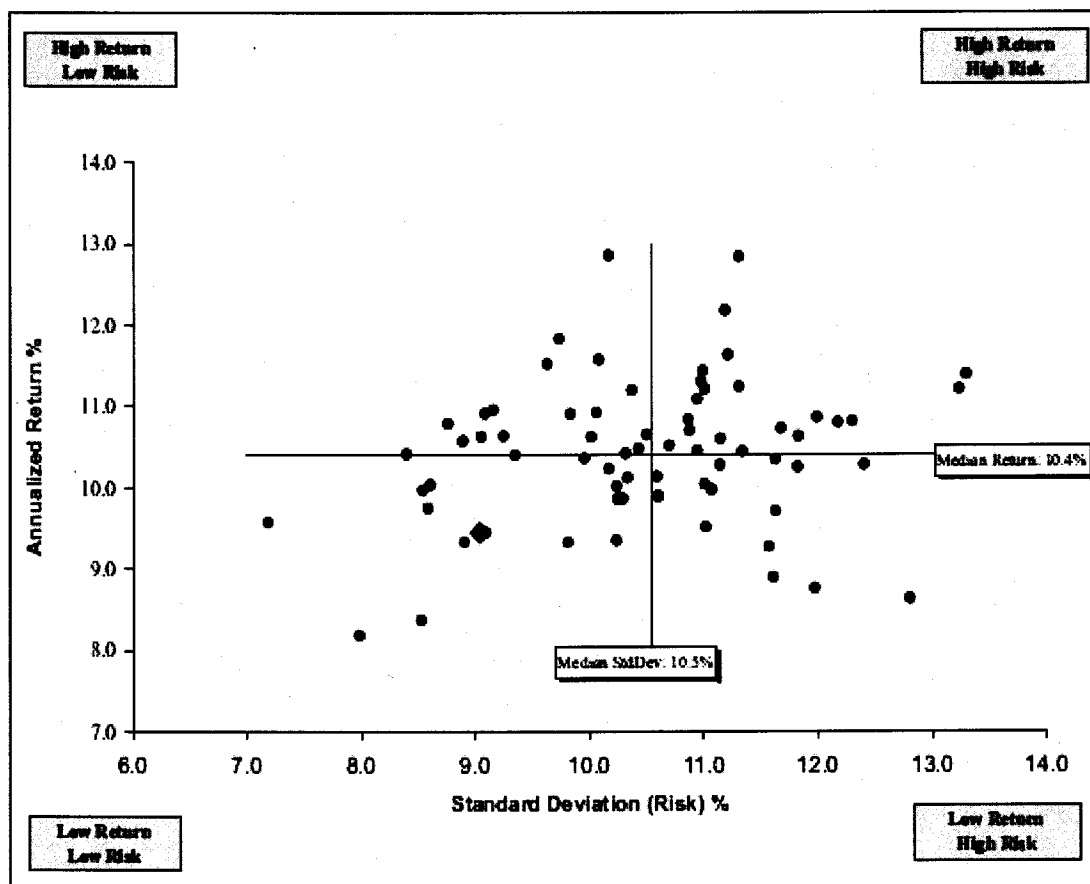
Rebalancing Assets – Once institutional investors achieve the desired asset allocation a technique called “rebalancing” is used to maintain appropriate asset class mixes in their portfolios. While the significant out performance of the stock market versus the bond market during the 1995 to 2000 period greatly assisted the Board in reaching its goal of increasing pension fund equity investments, the stock market’s precipitous fall beginning in September 2000 reversed that trend. At the stock market’s peak in 2000, 63.0 percent of pension assets were invested in equities, but by year-end 2000 the equity allocation had fallen to 57.0 percent.

When the stock market began its decline, the Board began a rebalancing process to bring the equity allocation back up to an acceptable range. During fiscal years 2001 through 2003, \$413.0 million of fixed income investments were sold and \$1.0 billion in equity investments purchased. Due to this rebalancing, the equity allocation of the pension funds stood at 63.0 percent at fiscal year-end 2003 and the portfolios were well positioned to benefit from the 19.11 percent return of the S&P 500 Index in fiscal 2004.

Investment Risk and Return – Any discussion of pension fund asset allocation should include a thorough discussion of the relationship of “risk and rewards.” When the stock market began its fall we occasionally received comments stating that pension funds should not have been invested in the stock market, but rather investing in ultra safe US Government Bonds. While this may sound like a good idea it simply does not work in the context of public pension fund investing. First, long-term US Government bonds have historically yielded only 5.4 percent annual, which is significantly below the actuary assumptions and would therefore dramatically increase the unfunded liabilities of the systems.

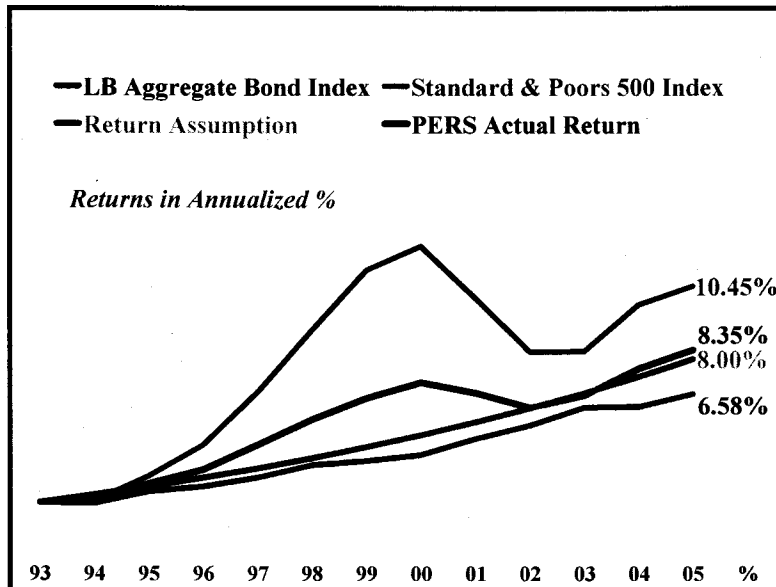
Second, while the principal of US Government Bonds is totally safe if the bonds are held to maturity, the actual par value of the bonds is not considered to be the value of the bonds for actuarial purpose. The actuary valuation of pension fund portfolios is based on the “mark-to-market” procedure which requires that the bonds be priced on the effective date of the valuations – what a buyer would be willing to pay for the bond on that date. Under certain interest rate conditions, US Government Bonds may be worth far less than they were the previous year. In fact, under the worst conditions a “mark-to-market” procedure could actually show an investment loss on the bonds during the year. This circumstance would occur when the value of the bonds during the year decreases more than the interest earned on the bonds. For example, if the bonds pay 5.0 percent interest annually and the value of the bonds decline 6.0 percent during the year, an investment loss will occur.

To determine how “risky” Montana’s pension portfolios are it may be helpful to compare Montana’s pension portfolios to other public funds. The Board provides investment data to R. V. Kuhns and Associates, a consulting firm that surveys 85 public pension funds and publishes the results. The firm’s chart below depicts the Public Employees’ Retirement System’s (PERS) risk/return portfolio analysis compared to other public pension funds. The green square representing PERS is located in the lower left quadrant, which means that the portfolio is subject to less risk than its peers but also generates lower returns. The data represents a 10-year period, ending December 31, 2004.



Asset Allocation Impacts – Perhaps the best way to measure the success of the Board’s asset allocation process is to determine if it has achieved its objectives over long periods of time and differing market conditions.

- Were assets properly diversified to reduce risk and increase investment return?
- Was the return achieved sufficient for the risk involved?
- Did the asset allocation achieve the 8.0 percent actuarial return requirement?



Based on the chart on the previous page Montana’s pension fund assets, while embodying less risk than peers, also achieved lower returns than the median return of other public pensions. However, as shown in the adjacent graph, the pension fund portfolios as represented by the PERS actual annual returns of 8.35 percent exceeded the 8.0 percent actuarial return requirements during the 12-year period.

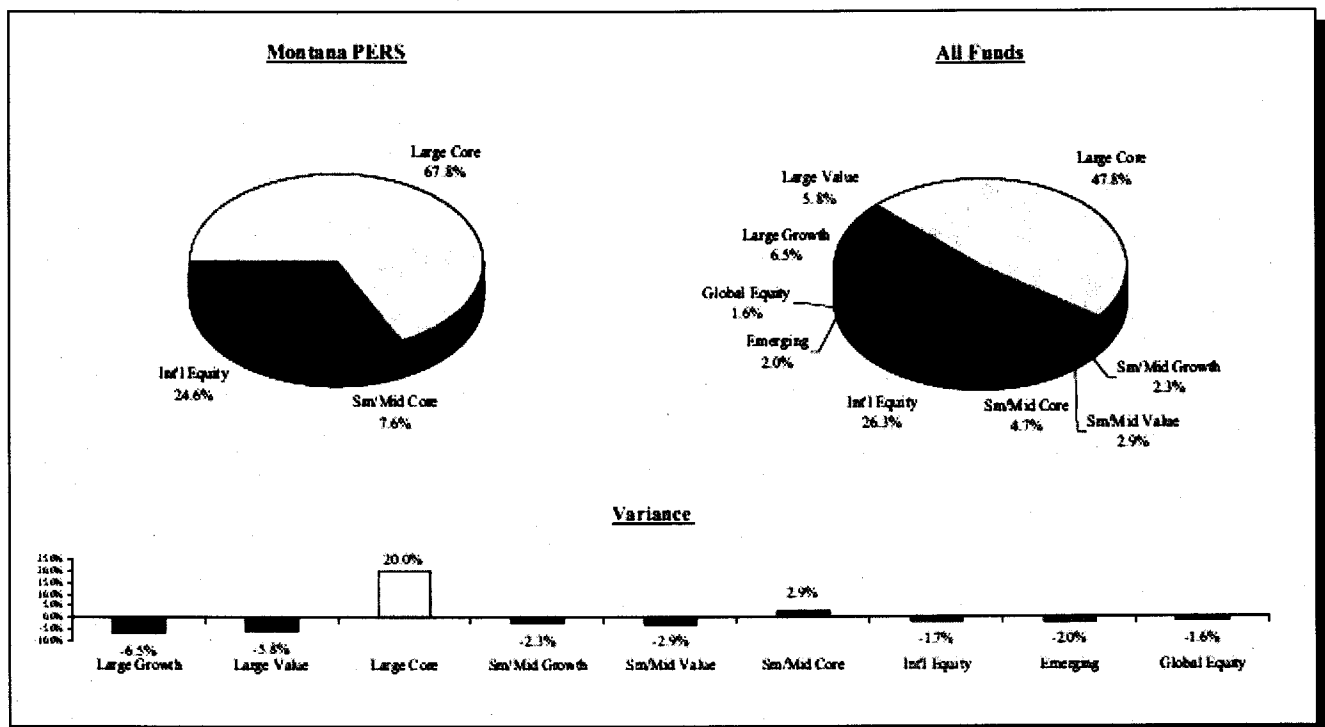
The chart also shows that during the steep stock market drop in 2001, the PERS portfolio, while also declining was somewhat protected by its fixed-income assets which performed very well when

the stock market dropped. As expected, with a mix of fixed income and equity assets the actual annual PERS returns were between the stock market annualized returns of 10.45 percent and bond market returns of 6.58 percent. The PERS returns would have been closer to the stock market returns if a larger portion of its assets had been invested in equities earlier in the period (only 32 percent invested in equities at the beginning of the period).

Summary – While this report has focused on major asset allocation classes only, the asset allocation process goes much deeper. Within most major asset classes there are several sub asset classes that may be selected to further diversify the portfolio and which may respond differently to economic and market conditions. For example, the domestic stock market may be sliced into many different investment pieces as shown below:

- | | | |
|------------------|------------------|-----------------|
| • Large-Cap Core | Large-Cap Growth | Large-Cap Value |
| • Mid-Cap Core | Mid-Cap Growth | Mid-Cap Value |
| • Small-Cap Core | Small-Cap Growth | Small-Cap Value |

Additionally, each of the subclasses may be managed passively (directly tied to an index) or managed actively in an attempt to “beat” the index. A comparison of Montana’s pension fund equity allocations to other public pension funds as compiled by R. V. Kuhns and Associates is shown on the next page.



The chart shows that Montana's pension fund equity portfolio is not as diversified as is the other public pension funds. The Board has recently hired a consulting firm to assist it in reviewing additional asset classes in which pension funds are not currently invested and how those assets may further diversify the portfolios while generating additional returns and reducing volatility. The firm will also conduct an Asset/Liability Study of the Teachers' Retirement System to determine how the system's assets should be allocated to cover the system's liabilities over the long-term. After this Asset/Liability Study is concluded, the firm will conduct a similar study of the PERS.

MEMORANDUM

Montana Board of Investments

Department of Commerce

2401 Colonial Drive, 3rd Floor

Helena, MT 59601

(406) 444-0001

To: David D. Bohyer, Director
Office of Research and Policy Analysis

From: Carroll South, Executive Director

Date: October 24, 2005

Subject: Requested Investment Information

I am writing in response to your letter of October 13, 2005, in which you ask for information regarding the Board of Investments' investment transactions that relate to the actual and actuarial losses in the state's retirement systems during the calendar year 2000-2003 time frame.

Actual Investment Loss versus Actuarial Investment Loss – It is important to note the different meaning of the terms “actual investment loss” and “actuarial investment loss.” While both terms relate to investment performance, the calculation methodology and results are totally different. The table below illustrates the significantly different results of “investment” and “actuarial investment” gain and loss calculations.

PERS Assets For Illustration Purposes Only

Fiscal Year	Beginning Fair Value	Ending Fair Value	Absolute (Loss)/Gain	Actuary 8% Assumption	Plus/Less Cash Flow	Adjusted Assumption	Actuarial (Loss)/Gain
1994	1,300,428,994	1,333,621,280	33,192,286	1,404,463,314	6,507,000	1,410,970,314	(77,349,034)
1995	1,333,621,280	1,542,959,690	209,338,410	1,440,310,982	(8,714,000)	1,431,596,982	111,362,708
1996	1,542,959,690	1,736,820,889	193,861,199	1,666,396,465	(6,131,000)	1,660,265,465	76,555,424
1997	1,736,820,889	2,079,632,719	342,811,830	1,875,766,560	4,206,000	1,879,972,560	199,660,159
1998	2,079,632,719	2,421,954,192	342,321,473	2,246,003,337	(6,620,000)	2,239,383,337	182,570,855
1999	2,421,954,192	2,708,274,128	286,319,936	2,615,710,527	(7,081,000)	2,608,629,527	99,644,601
2000	2,708,274,128	2,910,869,949	202,595,821	2,924,936,058	(2,289,000)	2,922,647,058	(11,777,109)
2001	2,910,869,949	2,762,155,708	(148,714,241)	3,143,739,545	(2,644,000)	3,141,095,545	(378,939,837)
2002	2,762,155,708	2,559,675,163	(202,480,545)	2,983,128,165	(9,613,000)	2,973,515,165	(413,840,002)
2003	2,559,675,163	2,684,105,984	124,430,821	2,764,449,176	(34,326,000)	2,730,123,176	(46,017,192)
2004	2,684,105,984	3,017,022,856	332,916,871	2,898,834,463	(24,529,000)	2,874,305,463	142,717,393
2005	3,017,022,856	3,232,788,978	215,766,122	3,258,384,684	(29,990,000)	3,228,394,684	4,394,294
Total for Period			1,932,359,984				(111,017,740)

The brown numbers represent the actual fair value of the Public Employees' Retirement System (PERS) invested assets at the beginning and ending of each fiscal year and the “investment” gain or loss for the year. An actual “investment” loss occurred during only two of these 12 years.

The red numbers represent the methodology that would be used by the actuary to determine the “actuary investment” gain or loss and is shown for illustration purposes only. The first column

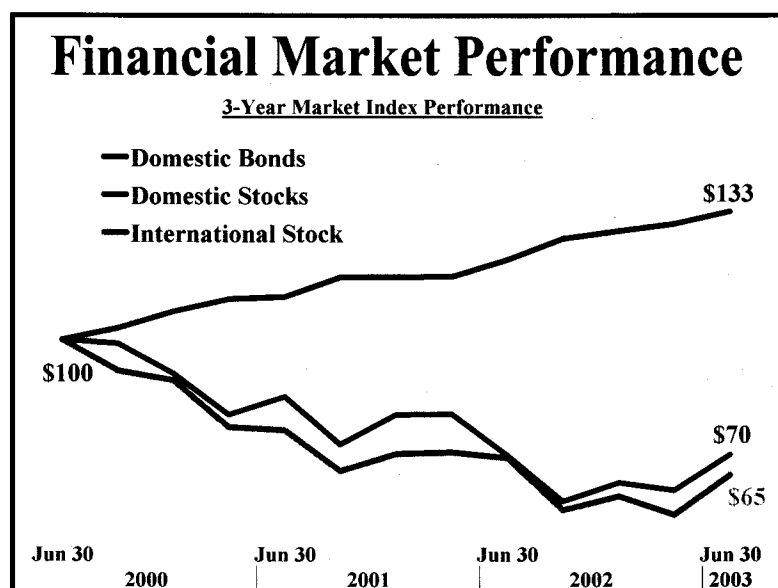
depicts what the fair value of the assets should have been at fiscal year-end based on an 8.0 percent return assumption. The second column reflects the positive or negative cash flow in the fund based on the difference between contributions received and benefits paid. The third and fourth columns represent the actuary 8.0 percent assumptions adjusted for cash flow and the "actuarial investment" gain or loss for the year. During this 12-year period in which PERS invested assets actually gained \$1.9 billion in value, there would have been an "actuary investment" loss of \$111.0 million.

The actuary addresses the volatility of investment return by "smoothing" gains and losses over a period of time. The PERS actuary uses a four-year smoothing methodology, while the TRS (Teachers' Retirement System) actuary uses a five-year process. As long as there are gains or losses to carry forward using this process, the Actuarial Asset Value will be more or less than the Actual Asset Value.

The Equity Markets - It was the large decline in the equity markets that caused the actual loss of assets in the state's retirement systems, rather than individual securities transactions. The Standard and Poor's (S&P) 500 Index, which represents 80.0 percent of the domestic stock market fell precipitously as did the Morgan Stanley Capital International Index - Europe and Far East (MSCI EAFE), representing the developed stock markets in Europe, Australia, and the Far East as shown below:

<u>Equity Type</u>	<u>High</u>	<u>Date</u>	<u>Low</u>	<u>Date</u>	<u>% Decline</u>
S&P 500 Index	1,527.5	Mar-00	776.8	Oct-02	49.15%
MSCI EAFE	1,760.0	Dec-99	868.5	Mar-03	50.65%

Because more than 55 percent of retirement fund assets were invested in these markets at the beginning of the three-year period, the sharp market declines would have reduced asset values regardless of individual security transactions. Montana was not alone in experiencing a reduction in retirement asset values due to equity market performance. Most private and public retirement funds are heavily invested in equities because history has shown that equity markets out-perform fixed-income markets over long periods of time.



The adjacent chart depicts how the broad bond and public stock markets performed from July 1, 2000 through June 30, 2003. Fortunately, during the sharp equity market decline the domestic bond market performed exceptionally well, offsetting some equity losses. One hundred dollars invested passively at the beginning of the period in the Lehman Brothers Aggregate Bond Index (an index that includes more than 6,000 domestic corporate and government bond issues) would

have been worth \$133 at the end of the period. The same amount invested in the S&P 500 Index and the MSCI EAFE Index would have been worth only \$70 and \$65 respectfully. This chart depicts the true market performance during the period and does not reflect the effect of any individual security transactions.

Market Impact versus Investment Transactions Impact – It is unclear as to what type of “investment transaction” you refer relative to investment losses. During this three-year period, Board staff and the Board’s external investment managers conducted several thousand individual retirement fund security transactions involving the purchase and sale of fixed-income and equity securities. These records are available to you, but would likely not shed any light on whether these transactions in some way contributed to actual investment losses.

Perhaps the best way to differentiate between financial market impact and security transaction impact (active management) on pension assets is to isolate, to the extent possible, the effect of security transactions from the impact of the financial markets. When Fiscal 2001 began 87.0 percent of PERS was invested in three broad asset classes that could have been passively indexed so their performance was solely based on financial market performance. These asset classes are shown below:

<u>Asset Class</u>	<u>%</u>	<u>Financial Market Index</u>
Large Company Domestic Stock	49.0%	S&P 500 Index
International Stock	7.3%	MSCI EAFE Index
Domestic Bonds	<u>30.7%</u>	Lehman Brothers Aggregate Index
Total	<u>87.0%</u>	

The pure financial market performance of these asset classes would have driven at least 87.0 percent of the overall investment performance of PERS assets during the period. The tables that follow compare the actual recorded investment performance of the assets to the same assets had they been passively invested in these indexes, thereby removing security level “investment transactions.” The period covered is Fiscal Years 2001, 2002, and 2003. The investment return for the remaining 13.0 percent of the portfolio is the actual investment performance recorded by the custodial bank. (Performance for the other state pension funds would be similar to PERS.)

<u>PERS Assets</u>	<u>Fair Value July 1, 2000</u>	<u>% of Total</u>	<u>Investment Return</u>	<u>Fair Value June 30, 2001</u>	<u>Market (Loss)/Gain</u>
S&P 500 Index	1,424,094,480	48.92%	-14.82%	1,213,043,678	(211,050,802)
MSCI EAFE Index	213,359,973	7.33%	-23.61%	162,985,683	(50,374,290)
Real Estate Trust Stock	66,935,047	2.30%	7.52%	71,968,563	5,033,516
Private Equity	111,817,960	3.84%	-8.57%	102,235,161	(9,582,799)
Equity Real Estate	6,600,919	0.23%	10.40%	7,287,415	686,496
Equity	<u>1,822,808,379</u>	<u>62.62%</u>		<u>1,557,520,499</u>	<u>(265,287,880)</u>
LB Aggregate Index	895,919,120	30.78%	11.23%	996,530,837	100,611,717
Montana Mortgages	134,390,346	4.62%	12.80%	151,592,310	17,201,964
Cash Equivalents	57,752,104	1.98%	6.43%	61,465,564	3,713,460
Fixed Income	<u>1,088,061,570</u>	<u>37.38%</u>		<u>1,209,588,712</u>	<u>121,527,142</u>
Total	<u>2,910,869,949</u>	<u>100.00%</u>		<u>2,767,109,211</u>	<u>(143,760,738)</u>
Less Negative Cash Flow				<u>(2,644,000)</u>	
Market Impact Total Adjusted for Negative Cash Flow				<u>2,764,465,211</u>	
Actual Assets at Year-End				<u>2,762,155,708</u>	
Loss due to Active Management					

If the asset classes shown in red had been passively invested in financial market indexes at the beginning of fiscal 2001, eliminating any individual security transaction impacts during the year, PERS assets at year-end would have been \$2.3 million more than the actual value that reflects actively managing the bulk of these assets. The negative cash flow resulting from benefit expenditures exceeding contributions is subtracted from the "market" impact calculations because it is reflected in the actual asset value.

While the equity markets performed poorly during fiscal 2001, the \$265.3 million loss on equity investments was partially offset by a \$121.5 million gain in the domestic bond market.

<u>PERS Assets</u>	<u>Fair Value</u> <u>July 1, 2001</u>	<u>% of</u> <u>Total</u>	<u>Investment</u> <u>Return</u>	<u>Fair Value</u> <u>June 30, 2002</u>	<u>Market</u> <u>(Loss)/Gain</u>
S&P 500 Index	1,286,773,574	46.59%	-17.97%	1,055,540,363	(231,233,211)
MSCI EAFE Index	196,691,573	7.12%	-9.50%	178,005,874	(18,685,699)
Private Equity	101,645,745	3.68%	9.43%	111,230,939	9,585,194
Equity Real Estate	7,034,917	0.25%	-1.34%	6,940,649	(94,268)
Equity	1,592,145,809	57.64%		1,351,717,824	(240,427,985)
LB Aggregate Index	920,352,036	33.32%	8.63%	999,778,416	79,426,381
Montana Mortgages	152,020,796	5.50%	8.91%	165,565,849	13,545,053
Cash Equivalents	97,637,067	3.53%	2.97%	100,536,888	2,899,821
Fixed Income	1,170,009,899	42.36%		1,265,881,153	95,871,254
Total	<u>2,762,155,708</u>	<u>100.00%</u>		<u>2,617,598,978</u>	<u>(144,556,730)</u>
Less Negative Cash Flow				(9,613,000)	
Market Impact Total Adjusted for Negative Cash Flow				<u>2,607,985,978</u>	
Actual Assets at Year-End				2,559,675,163	
Loss due to Active Management					

If the three asset classes shown in red had been passively invested in financial market indexes at the beginning of fiscal 2002, eliminating any individual security transaction decisions during the year, PERS assets at year-end would have been \$48.3 million more than the actual value that reflects actively managing the bulk of these assets. The negative cash flow resulting from benefit expenditures exceeding contributions is subtracted from the "market" impact calculation because it is reflected in the actual asset value at year end.

For the second consecutive fiscal year, the equity markets performed poorly; but once again the domestic bond market gained \$95.9 million, partially offsetting the \$240.4 million equity market loss.

<u>PERS Assets</u>	<u>Fair Value July 1, 2002</u>	<u>% of Total</u>	<u>Investment Return</u>	<u>Fair Value June 30, 2003</u>	<u>Market (Loss)/Gain</u>
S&P 500 Index	1,138,867,349	44.49%	0.25%	1,141,714,518	2,847,168
MSCI EAFE Index	215,598,195	8.42%	-6.06%	202,532,945	(13,065,251)
Private Equity	95,926,866	3.75%	5.15%	100,867,100	4,940,234
Equity Real Estate	7,035,303	0.27%	6.54%	7,495,411	460,109
Total Equity	<u>1,457,427,713</u>	<u>56.94%</u>		<u>1,452,609,974</u>	<u>(4,817,740)</u>
LB Aggregate Index	858,466,949	33.54%	10.41%	947,833,358	89,366,409
Montana Mortgages	178,441,866	6.97%	4.93%	187,239,050	8,797,184
Cash Equivalents	65,338,635	2.55%	1.54%	66,344,850	1,006,215
Fixed Income	<u>1,102,247,450</u>	<u>43.06%</u>		<u>1,201,417,258</u>	<u>99,169,808</u>
Total	<u>2,559,675,163</u>	<u>100.00%</u>		<u>2,654,027,231</u>	<u>94,352,068</u>
Less Negative Cash Flow				<u>(34,326,000)</u>	
Market Impact Total Adjusted for Negative Cash Flow				<u>2,619,701,231</u>	
Actual Assets at Year-End				<u>2,684,105,984</u>	
Gain due to Active Management					

If the three asset classes shown in red had been passively invested in financial market indexes at the beginning of fiscal 2003, eliminating individual security transaction decisions during the year, PERS assets at year-end would have been \$64.4 less than the actual value that reflects actively managing the bulk of these assets. The negative cash flow resulting from benefit expenditures exceeding contributions is subtracted from the "market" impact calculation because it is reflected in the actual asset value at year end. For the third consecutive fiscal year, the equity markets performed poorly; but the domestic bond market gained \$99.2 million, totally offsetting the \$4.8 million equity market loss.

During the three year period covered by the preceding tables, the market-driven performance of these asset classes representing 87.0 percent of PERS assets at the beginning of the period would have resulted in approximately \$13.8 million less in PERS assets than the actual investment performance, which reflects active management at the security level by Board staff and external managers.

Individual Investment Transactions versus Asset Allocation – While the focus of your letter seems to be on investment transactions, over the long term investment return is largely based on asset allocation. Institutional investors who are not limited by legal restraints invest assets in numerous asset classes to reduce risk, increase returns, and diversify assets. Much of that allocation decision is based on historical performance over extended periods of time.

The table at right depicts the long term performance of various asset classes from 1926 to 2004 as calculated by Ibbotson. The red asset classes are considered fixed income, while the brown asset classes are equities. Although historical performance does not guarantee similar future performance, it is obvious from this history that an 8.0 percent return as assumed by the retirement fund actuaries could not have been achieved during this period without a substantial

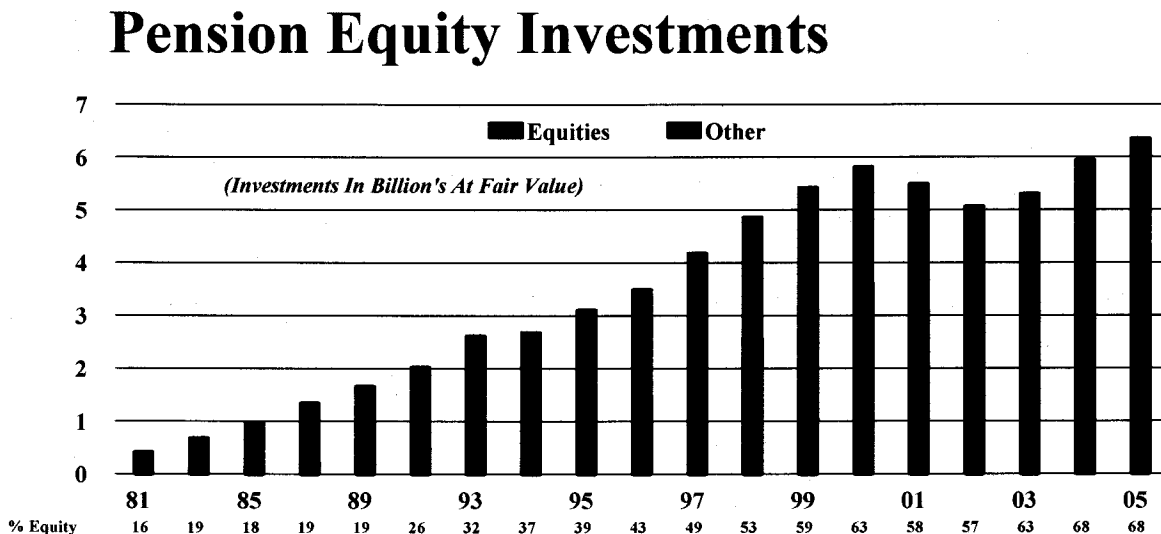
<u>Annualized Return *</u>	
<u>Investment Type</u>	<u>1926-2004</u>
Long-term Domestic Corporate Bonds	5.90%
Long-term Government Bonds	5.40%
Intermediate-term Government Bonds	5.36%
US Treasury Bills	3.72%
Large-cap Domestic Stock	10.43%
Small-cap Domestic Stock	12.74%
<small>* Ibbotson data</small>	

allocation of retirement assets to equities. However, equity performance is much more volatile than is fixed-income performance and during bear equity markets, such as occurred in fiscal years 2001 and 2002, a large equity allocation will detrimentally impact retirement assets.

While an “after the fact” analysis might suggest that when the equity markets began their precipitous fall, equity investments should have been sold in large numbers and replaced with fixed-income investments (which performed very well during the equity bear market), most retirement fund investors do not react to these conditions in that manner. First, even the shrewdest investor cannot predict when or how far the equity markets will fall. Second, once retirement fund investors establish an asset allocation between fixed-income and equity asset classes to generate the anticipated return, a rebalancing procedure is usually employed to ensure that the actual asset allocation remains fairly close to the targets.

When the actual asset allocation falls outside the acceptable ranges due to one asset class significantly outperforming another, the re-balancing process requires an investor to sell down the outperforming asset class and purchase the under performing asset class. While this may seem counter intuitive, the process ensures that at least at the major asset class level, retirement fund investors “sell high and buy low” until the allocation is brought back into the acceptable ranges. Perhaps a more enlightening exercise than looking at investment security transaction would be the asset allocation decisions (rebalancing) made by the Board during the three-year period in question.

At the beginning of the period, the Board had nearly achieved its goal of investing 65.0 percent of pension assets in equities. On July 1, 2000, equities comprised 63 percent of total retirement fund assets, but the equity allocation fell significantly when the equity markets dropped and the bond market performed well. The equity allocation did not reach 63 percent again until June 30, 2003 as shown in the following chart.



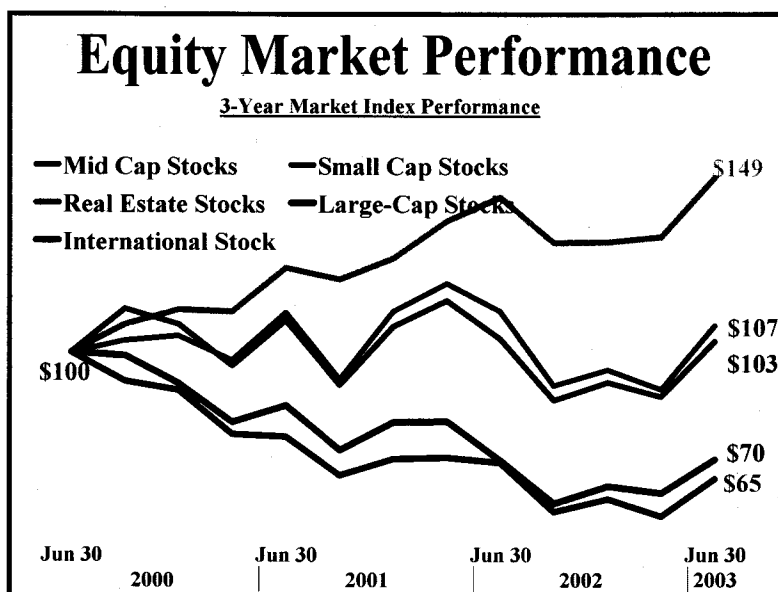
The equity allocation recovery was not due to equity market performance which actually dropped sharply during the period, but because the Board rebalanced to bring the equity allocation into the target range. In fact, the broad equity markets were still down significantly

from their levels at the beginning of the three-year period. During this three-year period the Board made major asset allocation decisions for the nine retirement funds as part of the rebalancing process as shown below:

<u>Asset Type</u>	<u>Fiscal 2001</u>	<u>Fiscal 2002</u>	<u>Fiscal 2003</u>	<u>Total</u>
Sold Fixed Income	(30,691,504)	(168,896,158)	(213,482,974)	(413,070,636)
Purchased Equity	328,359,292	360,904,154	338,509,981	1,027,773,427

During the period, the Board sold \$413.0 million in fixed income investments and purchased \$1.0 billion in equity investments. Approximately 76.0 percent of investment income distributed during the period was also used to purchase equities. Due to this significant rebalancing that brought equity allocations closer to the target range, the Board was positioned to better participate in the outstanding performance of the major equity markets in fiscal 2004. That year the S&P 500 Index and MSCI EAFE returned 19.11 percent and 32.85 percent respectively.

The Importance of Asset Allocation – Because asset allocation significantly impacts investment performance, it may be helpful to review the Board's retirement funds asset allocations at the beginning of the period to determine if there were asset classes in which the funds were not invested but that performed well during the period. The chart below compares the performance of three asset classes in which the Board had not invested retirement funds to the two major equity classes in which approximately 55.0 of retirement assets were invested.



Mid-Cap stocks are represented by the S&P 400 Index, covering approximately 7.0 percent of the domestic equity market. Small-Cap stocks are represented by the S&P 600 Index, which covers approximately 3.0 percent of the domestic equity market.

Mid-Cap companies range from \$1.0 billion to \$4.0 billion in market value. Small-Cap companies range in market value from \$300 million to \$1.0 billion.

Real Estate Stocks are represented by the Morgan Stanley Real Estate

Investment Trust Index, comprised of Real Estate Trust companies that issue stock to purchase and manage various type of real estate.

During the three-year period, these asset classes performed much better than Large-Cap domestic stock (represented by the S&P 500 Index) and international stock (represented by the MSCI EAFE Index). To the extent that some retirement fund equity assets had been invested in these asset classes at the beginning of the period, investment performance would have improved but with somewhat more risk because Mid and Small-Cap stock present more risk than do Large-Cap

stock. To further diversify retirement fund assets, the Board began investing in Small-Cap stock in February 2003 and in Mid-Cap stock in December 2004.

What about the Future? – The 2005 actuary valuations of PERS and TRS show a large unfunded liability in both plans. The calculated unfunded liability is based on the assumption that consistent investment return on assets will be 8.0 percent for PERS and 7.75 percent for TRS. To the extent that investment returns are less than these assumptions, the calculated unfunded liability will increase. And, it is not likely that investment return in the future will be sufficiently above these assumptions to assist in reducing the unfunded liability.

Asset allocation decisions going forward will be critical to the Board's achieving the investment return assumptions. To assist the Board in achieving this goal, it is hiring an investment consultant to conduct an Asset/Liability Study of these systems and recommend to the Board how best to achieve the assumed returns by investing in a diverse mix of asset classes. While attempting to increase return on pension assets, the Board must also be sensitive to the risk involved. In the investment world, increased return usually means increased risk as well.

Sources:

Board of Investments Financial Statements and Annual Reports

Custodial Bank accounting and performance records.

PERS Actuary Records

Standard & Poors Web Site

Morgan Stanley Web Site

Ibbotson